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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 330

ARKANSAS-MISSOURI POWER CORPORATION ..... *Petitioner*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS ..... *Respondents*

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

In an attempt to avoid the conflict between the decision of the Court of Appeals in the instant case and the decision of the Court of Appeals of the Fourth Circuit in the case of *Hummel-Ross Fibre Corporation* v. *Commissioner*, 79

F 2d. 474, the respondents offer and argue two points which they insist distinguish the instant case from the Hummel-Ross case and make that case inapplicable here.

Briefly, the points argued are (1) the absence of arms-length dealing, and (2) the bonds of petitioner were issued as a result of reorganization under § 77B of the Bankruptcy Act. The fallacies of these two points will be discussed in the order stated.

The respondents admit that the Hummel-Ross case, *supra*, sustains Petitioner's argument for apportionment of the fair market value of the property acquired by it between the bonds and stock issued therefor according to their respective market values, but contend that the rule established by that case is not applicable in a situation where bonds and stock are exchanged for property in a transaction, unless it was conducted at arms-length.

Then they assume that the bonds here involved were not issued in an arms-length transaction.

In the Hummel-Ross case, *supra*, discount on two separate and distinct bond issues was involved and the Court upheld the discount on both. The first issue was for $1,000,000 par value of bonds. For these bonds and 2,500 shares of Common Stock of the par value of $100 per share, having a market value of $40 per share, the issuing Company received $1,000,000.

The Court applied the rule of apportionment and allocated the $1,000,000 received for the stock and bonds on the basis of the market value of the stock, and thereby arrived at a discount on the bonds of $100,000.

The second issue of 8% bonds was in the amount of $698,850. The stockholders of the issuing Company paid $698,850 for this issue of bonds plus 1,397.7 of Common

Stock of the par value of $100 per share, which had a market value of $40 per share. The Court applied the same rule of apportionment and approved a discount on the second issue amounting to $55,908.

The details of the foregoing facts, while not appearing in the opinion of the Court, are reflected in the statement of facts found in the opinion of the Board of Tax Appeals, 31 BTA 451.

Thus, it is seen that the stockholders, those in control of the Company, purchased for themselves bonds and stock issued by their Company. There was certainly a fiducairy relation between the stockholders and the Company.

In *Natural Gas Pipeline Company* v. *Commissioner*, 45 BTA 939 (1941), the stockholders of the Pipeline Company surrendered old notes held by them for new notes and Common Stock and the Board of Tax Appeals allowed deductible discount in the amount of the fair market value of the stock received by the stockholders along with the new notes.

In neither of these cases was the arms-length issue raised, although the purchasers of the stock and bonds had absolute control of the issuer and seller thereof and could have dictated the terms of the transactions.

In both the Hummel-Ross case, *supra*, and the Natural Gas case, *supra*, as in the case at bar, the fair market value of the bonds and stock and of that which was received for them was established by findings of fact. These facts were sufficient to establish discount, despite the fiduciary relation between the parties to the transactions.

In the light of the facts found by the trial court (R. 31) and adopted by the Court of Appeals (Pet. 6A and 7A) "*as controlling*" (emphasis supplied), the transaction here

involved has all the earmarks of an arms-length bargain, *Pepper* v. *Litton*, 308 U. S. 295, 306, 84 L. Ed. 281; and meets the test of legality established by this Court. *Geddes* v. *Anaconda Copper Mining Company*, 254 U. S. 590, 599.

Therefore, respondents' position on the question of an arms-length transaction is untenable and is insufficient to escape the application of the apportionment rule established by the Hummel-Ross case, *supra*, and followed in *Pierce Oil Corporation* v. *Commissioner*, 32 BTA 403, and Natural Gas Pipeline Company, *supra*.

Had the rule of apportionment been applied to the controlling facts in the case at bar—and no sound basis for not applying it has been shown—it would have been demonstrated that the Petitioner received for its bonds $425,181 less than their par value, and, therefore, sold them at a discount.

The respondents argue that the bonds were not issued at a discount because they were issued in a reorganization under Section 77B of the Bankruptcy Act, which Act required that the assets of the bankrupt must be used to satisfy its claimants according to the strict priority of their claims. In support of this construction of the Act, they cite *Case* v. *Los Angeles Lumber Company*, 308 U. S. 106, 84 L. Ed. 110. It is true that this case laid down certain strict priority rules that should have been followed in a reorganization under that Act, and because of this requirement, respondents argue that the bondholders of the old company, since they were entitled to satisfaction in full, received such satisfaction, and therefore, Petitioner's bonds were not issued at a discount, notwithstanding the actual facts as found by the Courts below. This contention has no foundation if the plan of reorganization involved here shows that the strict priority rule was not followed.

The Plan of Reorganization approved in the instant case in no respect met the rule laid down in the Los Angeles Lumber Company case, *supra*, and relied upon by the respondents. On the contrary, the debenture and note holders did not receive full satisfaction of their claims although holders of the bankrupt's Preferred Stock were given 2 shares of Common Stock of the new corporation for each share of the Preferred of the old corporation (See page 3, Plan, R 51). Furthermore, on page 2 of the Plan, it is recited as follows:

> "The contributors to the plan have approached the reorganization of the Company with the following objectives in mind: * * Second. A proper distribution should be made to those entitled to participate in the reorganization based on the equities involved *and taking into consideration in the case of Preferred stockholders the value of their cooperation to the Company and its creditors.*" (Emphasis supplied.)

A like provision of the Plan of Reorganization was involved in the Los Angeles case, *supra*, and condemned by this Court.

A study of the Plan here involved discloses that it in no respect met the requirements of Section 77B of the Bankruptcy Act as interpreted and applied by this Court in the Los Angeles case, *supra*, and that it was only an agreed plan such as might have been set up and agreed to by the interested parties without the aid of the District Court, as was done in the Natural Gas Pipeline Company case, *supra*. Without the consent of all parties, the plan here involved could not have withstood an attack.

The Plan, not having been valid, cannot be used or siezed upon to sidestep and distinguish the holding of the Court in the Hummel-Ross case, *supra*, or to avoid the

legal effect of apportionment contended for by petitioner. The refusal of the Court of Appeals to follow the Hummel-Ross case and apply the apportionment rule to the established facts here, creates, under the facts and circumstances, an irreconcilable conflict between the Courts of Appeals of two circuits.

The respondents in a footnote on page 7 of their brief, suggest, if they do not urge, that the Petitioner did not contemplate discount at the time of the bond issue, since it did not set up its books on a discount basis, and therefore, no discount should be recognized.

Whether discount exists or not is not controlled by book entries. *San Joaquin Light and Power Company v. McLaughlin*, 65 F. 2d 677.

For the reasons stated in its petition and in its reply to respondents' brief, it is urged that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

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